

## Internal Revenue Service

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Person To Contact:

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Telephone Number:

Refer Reply To:

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### Legend:

Taxpayer =

Contractor =

Entity =

Venture =

Tax Year =

a =

b =

c =

d =

e =

Dear :

This is in reply to a letter dated July 8, 2010, requesting a ruling on behalf of Taxpayer. Taxpayer has requested a ruling regarding the definition of “qualified health care property” under section 856(e)(6)(D) of the Internal Revenue Code, for purposes of the related-party rent exception of section 856(d)(2)(B).

**Facts:**

Taxpayer is a domestic corporation that elected to be treated as a real estate investment trust (REIT) beginning in Tax Year. Taxpayer uses an overall accrual method of accounting and the calendar year as its taxable year.

Taxpayer intends to enter into a joint venture with Contractor establishing Entity. Taxpayer will contribute property and cash to Entity, resulting in an a percent ownership interest in Entity and Contractor will contribute property, resulting in a b percent ownership interest. It is anticipated that Entity will own c properties (the Properties) in d states. As part of the transaction, Entity will structure the Properties to conform with section 856(d)(8)(B).

Entity will lease the Properties to Venture, a joint venture between a taxable REIT subsidiary (TRS) of Taxpayer and Contractor. Venture, in turn, will hire Contractor, or an affiliate of Contractor, to serve as an eligible independent contractor to manage and operate the facilities.

The Properties are senior living communities that contain both independent living (IL) and assisted living (AL) units, with some also offering Alzheimer's care. The majority of the Properties consist of a single building with an “age in place” structure. “Age in place” is an industry term used to describe a resident’s natural progression across the spectrum of services that the facility offers, starting with IL and ending with AL and/or Alzheimer’s Care. These “age in place” Properties consist of a single building with a mix of IL, AL, and Alzheimer’s Care residents. This structure allows residents to have access to increased services as their conditions warrant without the need to move them into a different facility.

The remaining e Properties consist of multiple buildings on the same campus that are operated as one facility. In these Properties the residents may utilize the amenities at each of the buildings and there is still substantial integration of the IL, AL, and Alzheimer’s Care services so that residents can move seamlessly between service offerings as health needs warrant.

All Properties provide residents with a periodic assessment (often quarterly) to determine if there is a change in the level of care services needed. Standard services available to all residents generally include daily meals in a community dining room, housekeeping, laundry, social and recreational activities, and transportation. Residents of all units have a daily check each morning and are generally required to check out if they leave the facility for an extended period of time. In addition to the standard services, AL residents receive assistance with activities of daily living (ADLs) including, bathing, dressing, grooming, toileting, escorting, medication management, and safety checks. These ADLs are provided as the resident's condition requires. The majority of the staff provides services to all residents as they function as one integrated community and all staff members are trained in first aid and CPR. There are some dedicated staff members who are specifically trained for and provide ADLs to the AL and Alzheimer's Care residents.

**Law and Analysis:**

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from sources that include rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from sources, that likewise include, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 856(d)(2)(B) provides that rents from real property does not include amounts received directly or indirectly from a corporation if the REIT owns 10 percent or more of the total combined voting power or 10 percent or more of the total value of the shares of the corporation.

Section 856(d)(8)(B) provides that amounts paid to a REIT by a TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) when a REIT leases a qualified lodging facility or qualified health care property to a TRS, and the facility or property is operated on behalf of the TRS by a person who is an eligible independent contractor.

Section 856(e)(6)(D)(i) defines qualified health care property as any real property which is a health care facility.

A “health care facility” is defined in section 856(e)(6)(D)(ii) as a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which was operated by a provider of such services that is eligible for participation in the Medicare program under Title XVII of the Social Security Act [subchapter XVIII of chapter 7 of Title 42 (42 U.S.C.A. § 1395 et seq.)] with respect to the facility.

In the present case, each Property is located in one building or on the same campus, and all of the AL units in the building are licensed by the state in which they are located. When a resident requires ADLs, the resident may transition from an IL unit to an AL unit (depending upon availability), which may or may not require the resident to physically move units (depending on the facility’s licensing). While not all of the residents of the Properties receive assisted living services, a significant number of units in each of the Properties will be occupied as AL units.

#### **Conclusion:**

Based on the facts as represented, we rule that the Properties are health care facilities within the meaning of section 856(e)(6)(D)(ii). Accordingly, amounts paid to the Taxpayer by the TRS shall not be excluded from rents from real property by reason of section 856(d)(2)(B) so long as the property is operated on behalf of the TRS by an eligible independent contractor.

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the fact herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code or whether Contractor qualifies as an eligible independent contractor under section 856.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Robert A. Martin  
Robert A. Martin  
Acting Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
(Financial Institutions & Products)